

The Advisory Committee of the National Securities Market Commission would like to thank CESR for the opportunity to contribute its opinions and viewpoints on transparency in corporate fixed income and derivatives markets and, in particular, on the current economic situation of those markets.

Attached please find the document expounding the Advisory Committee's perspective and responses to the questions raised by CESR in the questionnaire contained in the consultation paper entitled "CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity markets transparency" (CESR/10-510).

We are at your disposal to expand upon our answers to those questions.

Yours,

CESR/10-510; CESR Technical Advice to the European Commission in the context of the MiFID
Review: Non-equity markets transparency for Bonds

Introduction.

The Advisory Committee of the National Securities Market Commission serves the Commission in an advisory capacity. The Committee consists of representatives of market members in the official secondary markets, securities issuers, investors and bodies with powers in the area of the securities markets.

The Advisory Committee has been an active participant in previous consultation processes undertaken by the European Commission and CESR, having responded to the questions posed by both bodies in 2006, 2007 and 2008.

In those responses, the main arguments proposed by the Committee in favour of supporting an extension of the pre- and post-trading transparency requirements were as follows.

The lack of high transparency standards in markets in fixed-income instruments leads to the following inefficiencies:

- Mismatches between prices applied in purchase and sale transactions in fixed-income assets.
- Low level of retail investment in fixed-income assets.
- Lack of overall statistics for fixed-income markets.
- Difficulties for the European authorities to supervise the fixed-income markets properly.
- Impossibility for financial intermediaries to comply properly with the best execution requirement under MiFID for all customer orders and all financial products.

In its replies to this Consultation, the Committee wishes to emphasize that the information deficiencies of fixed-income markets, the informational asymmetries that exist between market participants (and not just between institutional and retail investors, at present), the difficulties of valuing fixed-income assets and the lack of a harmonised post-trade transparency regime for fixed-income securities and other derivatives that is enforceable throughout the EU, all lead to undesirable effects on the markets and hamper proper compliance with obligations under MiFID.

Therefore, in its replies to CESR, the Committee insists on the advisability of establishing a system of post-trade transparency for all fixed-income products.

We also consider it is necessary to establish guidelines for the most appropriate procedure for implementing the post-trade transparency system in the corporate bond market. In regulated markets, we believe the markets themselves should take on those functions; however, the

issue is vital in OTC markets, which handle part of the volume of trading in these instruments, and a Trade Repository is probably the most appropriate solution.

Additionally, in the case of OTC derivatives, even where some products must be taken to Trade Repositories, the use of centralised clearing will favour post-trade transparency. A side-benefit (not the main one) of centralised clearing is that, if considered appropriate, it provides greater public information about trades that were performed and, above all, about open interest, particularly in instruments that are settled by physical delivery. However, at the same time it is necessary to take proper precautions since excessively detailed disclosure of open interest in products in which the market is shallow may put holders of that position in a vulnerable situation.

I. General access to pre- and post-trade information

Q.1: On the basis of your experience, could you please describe the sources of pre- and post-trade information that you use in your regular activity for each of the instruments within the scope of this consultation paper:

- a) corporate bonds**
- b) structured finance products (ABS and CDOs)**
- c) CDS**
- d) Interest rate derivatives**
- e) equity derivatives**
- f) foreign exchange derivatives**
- g) commodity derivatives.**

In the case of instruments that are quoted on a Regulated Market with mechanisms for receiving transaction information, the RMs are in charge of providing information on the size and price of trades and, generally, of providing transparency on transactions occurring in the secondary market.

As for OTC instruments, less information is available, and what is available is more scattered and may be available commercially via professional financial data feeds or restricted websites.

II. Corporate

1. Scope of corporate bonds transparency regime

Q.2: Are there other particular instruments that should be considered as 'corporate bonds' for the purpose of future transparency requirements under MiFID?

CESR's definition of corporate bond is generic and, in our opinion, includes the main characteristics of corporate bonds.

Nevertheless, Spain has a type of hybrid instrument called *participaciones preferentes* used fundamentally by private sector issuers to raise funds (Tier 1), although they do not grant the holder a stake in equity; they have traditionally been listed on Spain's RMs in fixed-income securities and, for the purposes of this consultation, should be classified as corporate bonds.

Q.3: In your view, would it be more appropriate, in certain circumstances, to consider certain covered bonds as structured finance products rather than corporate bonds for transparency purposes? Please explain your rationale.

No. Although the issuance of covered bonds in certain European jurisdictions involves using certain structuring techniques (e.g. picking the portfolio of assets at the financial institution that cover the liabilities to be issued), they should not be classified as structured products.

For example, when classifying assets that it will accept as collateral for monetary policy operations, the European Central Bank distinguishes between covered bonds and structured bonds.¹

2. Pre-trade transparency for corporate bonds

Q.4: On the basis of your experience, have you perceived a lack of pre-trade transparency either in terms of having access to pre-trade information on corporate bonds or in terms of the content of pre-trade transparency information available?

Yes, there is a lack of pre-trade transparency in the bond market in terms of both the information that is available and its degree of standardisation.

The lack of high standards of pre-trade transparency leads to market anomalies. The conclusions of CESR's 2007 report on transparency in the corporate bond market already mentioned the existence of information asymmetries between retail and wholesale investors. The financial crisis that commenced in 2007 and is continuing in 2010 has contributed to deepening those asymmetries, and has even extended them to other categories of institutional investor, such as UCITS, which have experienced great difficulties in valuing corporate fixed-income assets in their portfolios.

Q.5: In your view, do all potential market participants have access to pre-trade transparency information on corporate bonds on equal grounds (for example, retail investors)? Please provide supporting evidence.

No.

In response to previous Consultation Papers², a number of bodies and industry associations representing retail and institutional investors (FIN-USE, INVERCO, ABI, AFI2i, etc.) and issuers (European Issuers) have expressed concern about the transparency conditions, both pre- and post-trade, in the European corporate bond markets, and they set out the difficulties which these experience in day-to-day operations when valuing their portfolios properly, and about the problems of managing those portfolios and the inefficiencies and risks that this situation may produce for the markets.

Q.6: Is pre-trade transparency efficiently disseminated to market participants? Should pre-trade information be available on a consolidated basis?

1 European Central Bank. "The implementation of monetary policy in the euro area". November 2008.

2 CESR/08-1014. Transparency of corporate bond, structure finance product and credit derivatives markets Consultation Paper

In the case of financial instruments that are quoted on an RM, the latter is in charge of systematising the information and offering it to the market broadly in a standardised form.

In the case of unlisted bonds, the information is more dispersed and heterogeneous, and it is available via restricted-access professional news services.

Q.7: What are potential benefits and drawbacks of a pre-trade transparency regime for:

a) the wholesale market; and

b) the retail market?

If you consider that there are drawbacks, please provide suggestions on how these might be mitigated.

We do not believe that an increase in the level of pre-trade transparency would be detrimental to the market.

On the contrary:

1. Greater transparency in the bond market reduces transaction costs by 20%-50%, depending on the survey and the size of the transactions considered.³
2. Greater transparency enhances liquidity in the bond market (measured via trading volumes and bid-offer spreads) due to the aforementioned reduction in transaction costs and the informational asymmetries that exist in the market, which is therefore beneficial to less sophisticated investors⁴.
3. The use of centralised trading systems provides lower transaction costs than OTC systems.⁵
- 4.- Increased transparency intensifies competition between dealers and drives market innovation (leading to new products and tools)⁶.

3 Bessembinder, Maxwell and Ventarataman (2005) "Market Transparency, Liquidity Externalities, and Institutional Trading Costs in Corporate Bonds"

4 Bessembinder, Maxwell and Venkataraman (2005) "Market Transparency, Liquidity Externalities, and Institutional Trading Costs in Corporate Bonds" and Goldstein, Hotchkiss and Sirri (2005) "Transparency and Liquidity: A Controlled Experiment on Corporate Bonds,"

5 Biais, B. and R. Green, 2005, "The Microstructure of the Bond Market in the 20th Century," working paper, Toulouse University and Carnegie Mellon University.

6 Edwards, Nimalendran and Piwowar (2006) "Corporate Bond Market Transparency: Liquidity Concentration, Informational Efficiency, and Competition"; Laganá, Perina, Köppen-Mertes and Persaud (2006) "Implications for Liquidity from Innovation and Transparency in the European Corporate Bond Market"

These effects are beneficial for both retail investors (who have less information) and for institutional investors.

Q.8: What key components should a pre-trade transparency framework for corporate bonds have? What pre-trade information should be disclosed?

In pursuit of greater protection for retail investors, we consider that a future pre-trade transparency regime for corporate bonds should be mandatory for bond issues that are addressed at that investor category.⁷

In general, as with the MiFID requirements for equities, the pre-trade transparency rules for fixed-income securities should consider order size and the existence of mechanisms for proper information dissemination.

The relevant pre-trade information that should be disclosed is the price of the bonds and the trade volumes, providing the broad market with the range of bid-offer prices and the market depth at any given time.

3. Post-trade transparency for corporate bonds

Q.9: Do you think that notional value would be a meaningful piece of information to be made accessible to market participants? Is there any other information that would be relevant to the market?

Yes, the notional volume is an important datum for the market.

Also, in addition to the bond description (standardised via the ISIN or some other international identifier), the price and the deal size, we believe that, where the asset's servicing schedule permits, the IRR of the trade should also be disclosed as it is relevant to the market and useful for the market and investors.

Q.10: Do you agree with the initial proposal for the calibration of post-trade transparency for corporate bonds? If not, please provide a rationale and an alternative proposal (including supporting analysis).

We are broadly in agreement with the CESR proposal. In line with our reply above to Q.9, we would add only that it is necessary to disclose the transaction volume in all cases, i.e. without establishing a threshold of 5 million euro for disclosing this information and the IRR.

Q.11: Should other criteria be considered for establishing appropriate post-trade transparency thresholds?

Apart from the comment above about the need to disclose the volume in trades for a nominal amount of over 5 million euro and the transparency of other data, we broadly agree with CESR's approach.

⁷ Recently, Spain's AIAF fixed-income market has implemented SEND, a new electronic trading platform whose aim is to provide greater pre-trade transparency for fixed-income securities listed on AIAF.

Additionally, we believe implementation of post-trade transparency in the EU's bond markets should consider the following factors:

- Homogeneous; it should consist in a set of standard common rules for all participants in EU bond markets.
- Universality; it should apply to all corporate fixed-income securities within the EU.
- Real time; the information should be made available to investors as soon as possible, and, at all events, as close to real time as is viable.
- Maximum coverage; the information must be accessible electronically.
- Free access; the information must be freely accessible to all investors and market participants.

Q.12: Given the current structure of the corporate bond market and existing systems, what would be a sensible benchmark for interpreting “as close to real time as possible”?

The international bond markets currently have systems providing references for determining the time requirements for post-trade transparency.

The European Union has examples of post-trade transparency mechanisms that may be useful in this regard. In accordance with the option allowed under recital 46 of MiFID, when it transposed the Directive, Italy extended the post-trade transparency requirements to the bond market and established a post-execution transparency system. In Denmark, all financial institutions are obliged to publish prices on bond trades with a three-minute time lag. The Management Companies of Spain's Stock Exchanges where bonds are listed have tools for firms to disclose the main features of the trades in which they have participated, providing transparency in execution.

III. Structured Finance products (ABS and CDOs)

1. Pre-trade transparency for structured finance products

a) ABSs

Q.13: On the basis of your experience, have you perceived a lack of pre trade transparency in terms of access to and the content of pre trade information available in the market for ABS?

Yes.

As in the corporate bond market, there is a lack of pre-trade transparency in the ABS and CDO markets in terms of the information that is available and its degree of standardisation.

Q.14: Is pre trade transparency information readily available to all potential market participants?

No. The problem with these financial assets is similar to that mentioned for bond markets in the previous section of this reply.

Q.15: Is pre-trade information currently available in the ABS market consolidated and effectively disseminated to those market participants who make use of it?

In the case of financial instruments that are quoted on an RM, the latter is in charge of systematising the information and offering it to the market broadly in a standardised form.

In the case of unlisted bonds, the information is more dispersed and heterogeneous, and it is available via restricted-access professional news services.

Q.16: Which potential benefits and drawbacks of a pre-trade transparency regime do you see for the ABS market? If you see drawbacks, please explain how these might be mitigated.

See Q.7. The conclusions for ABS are similar to those for corporate bonds.

Q. 17: Which key components should a pre-trade transparency framework for ABS have? Which pre-trade information should be disclosed?

See Q.8. The conclusions for ABS are similar to those for corporate bonds.

b) CDOs

The response for CDOs is the same as set out above for ABS.

Q. 18 On the basis of your experience, have you perceived a lack of pre trade transparency in terms of access to and the content of pre trade information available in the market for CDOs?

Q.19 Is pre trade transparency information readily available to all potential market participants?

Q.20 Is pre trade information currently available in the CDO markets consolidated and effectively disseminated to those market participants who make use of it?

Q.21 Which potential benefits and drawbacks of a pre trade transparency regime do you see for the CDO market? If you see drawbacks, please explain how these might be mitigated.

Q.22 Which key components should a pre trade transparency framework for CDOs have? Which pre trade information should be disclosed?

2. Post-trade transparency for structured finance products

(Please indicate whether your response is relevant for both ABS and CDOs)

The following replies are applicable to both CDOs and ABS.

Q.23 Which of these criteria to determine the first phase of the phased approach do you consider most relevant? Are there other criteria which should be taken into account?

In line with previous submissions by the CNMV Advisory Committee to CESR⁸, we see no benefit in segmenting the market with a view to phased implementation of a post-trade transparency regime for structured products.

On the contrary, to avoid any regulatory arbitrage, we consider that whatever system is adopted should apply to all ABS and CDOs.

Q.24 Do you have specific ideas on which kind of ABS and which kind of CDOs should be covered by the first phase?

See Q.23.

Q.25 Do you consider that it would be appropriate to use the same framework for post trade transparency for corporate bonds and structured finance products? Please elaborate.

Yes.

For the purposes of determining the post-trade transparency regime for a fixed-income product and how it is to be treated, we do not believe there are significant differences between ABS and CDOs, on the one hand, and corporate bonds, on the other.

Moreover, insofar as the planned system for corporate bonds applies different treatment depending on transaction size, we consider it is valid for use with ABS and CDOs.

Q.26: If so do you agree that the same calibration parameters should be used for structured finance products as for corporate bonds? Or do you think different size and time thresholds should apply?

In line with the reply to Q.25, we consider that the calibration parameters for corporate bonds should be applied to structured finance products.

IV. Credit Default Swaps (CDS)

1. Pre-trade transparency for CDS

Q.27: On the basis of your experience have you perceived a lack of pre-trade transparency both in terms of access to and the content of the information available in the CDS market?

The participants in the CDS market, all of whom are professionals, can be assumed to have sufficient information about the market before making trades.

Q.28: Is pre-trade transparency information readily available to all potential market participants?

⁸ CESR/08-1014. Transparency of corporate bond, structure finance product and credit derivatives markets Consultation Paper.

Yes, insofar as most investors are professionals.

Q.29: Is pre-trade information currently available in the CDS market consolidated and effectively disseminated to those market participants who make use of it?

Yes, insofar as most investors are professionals.

Q.30: Which potential benefits and drawbacks of a pre-trade transparency regime for CDS do you see? If you see drawbacks, please explain how these might be mitigated.

Broadly speaking, there are no known drawbacks to pre-trade transparency.

Q.31: Which key components should a pre-trade transparency framework for CDS have? Which pre-trade information should be disclosed?

Pre-trade transparency should include bid and offer prices and volumes without identifying the bidders or offerors unless the transaction will be bilateral and the reliability of the counterparty is a decisive factor.

2. Post-trade transparency for CDS

Q.32: In your view, would the post-trade transparency calibration parameters (i.e. transaction size thresholds, information to be published and timing of publication) proposed for corporate bonds in Section IV be appropriate for a) Single name CDS? and b) Index CDS? If not, please elaborate the reasons and propose alternative parameters (including justifications).

Yes, it would be appropriate to consider those parameters, for all types of CDSs.

Q.33: In your view, should sovereign CDS be included within the post-trade transparency framework for CDS? And if so, should the calibration parameters for single name and sovereign CDS be aligned? If not, please explain why they should be different and propose an alternative approach for sovereign CDS (including justifications).

Yes, sovereign CDS should be included. The calibration parameters for sovereign CDS should not differ from those for single name CDS.

V. Derivatives (Interest rate derivatives, Equity derivatives, Commodity derivatives and Forex derivatives)

1. Pre-trade transparency for derivatives

Q. 34: On the basis of your experience have you perceived a lack of pre-trade transparency in terms of access to pre-trade information on a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives and the content of the information regarding these products available in the market?

Since most (in some cases, all) of the participants in these markets are professionals, they can be assumed to have pre-trade transparency. Where retail investors gain access to such markets (e.g. equity derivatives), they do so via regulated markets, which provide full pre-trade transparency.

Q. 35: Is pre-trade transparency readily available to all potential market participants?

Yes, with the comments made in reply to Q.34.

Q.36: Is the pre-trade information currently available in these markets consolidated and effectively disseminated to those market participants who make use of it? If necessary, please specify your answer by product.

Yes, in general. Where there is a retail market, the pre-trade information is not the same as for the wholesale market, so there is no consolidation.

Q.37: Which potential benefits and drawbacks of a pre-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.

Broadly speaking, there are no known drawbacks to pre-trade transparency.

Q. 38: Do you believe that pre-trade transparency would be desirable for some or all types of OTC derivatives (i.e. equity, interest rate, forex and commodity derivatives)? Which key components should a pre-trade transparency framework for any of these above mentioned derivatives have? Which pre-trade information should be disclosed?

The pre-trade transparency in RM is appropriate. Pre-trade transparency should include bid and offer prices and volumes without identifying the bidders or offerors unless the transaction will be bilateral and the reliability of the counterparty is a decisive factor.

2. Post-trade transparency for derivatives

Q.39: On the basis of your experience have you perceived a lack of post-trade transparency, both in terms of access to relevant information and the content of this information for any

of the following markets: a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives?

Not for instruments traded in RM. Post-trade transparency could evidently be improved.

Q.40: Do you believe that additional post-trade transparency would be desirable for all of the above instruments? If not, which ones would benefit from greater post-trade transparency?

The greater the retail participation, the greater the post-trade transparency requirements.

Q.41: Is post-trade transparency readily available to all potential market participants? Does this vary by asset class?

It is not readily available to all market participants; therefore, there is clearly scope to improve the existing levels of transparency.

Q.42: Which potential benefits and drawbacks of a post-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.

Transparency has few disadvantages. One possible disadvantage is that immediate disclosure of trades in instruments where trading is concentration in a small number of participants may put a holder in a vulnerable position.

Q.43: Which are the key components (e.g. qualitative or quantitative criteria) which should be taken into consideration when designing such a post-trade transparency framework?

In highly liquid instruments, any waivers or exceptions to post-trade transparency should be quantitative. In less liquid instruments, they can be qualitative.

Q.44: Do you think that a post-transparency regime could have some additional valuable externalities in terms of valuation, risk measurement and management, comparability and other uses in price discovering process on related underlying reference instruments?

Yes. Derivatives prices are linked directly to those of their underlyings. Therefore, improved transparency in the markets will have a positive impact by providing better knowledge of valuations and enhancing risk management and the comparability and discovery of the underlying prices.